

Retirement Costs

The Public Employee Retirement Administration Commission ([PERAC](#)) is responsible for monitoring, advising, and regulating 106 Massachusetts public pension systems. Annually, PERAC issues a report of each system's status (e.g., retirement board membership, last valuation date, return on investment, funding ratios, and investment vendors used) for the previous calendar year.

Each public pension system is overseen by a retirement board, which is bound by a fiduciary duty to manage the system in the best interest of the members and their beneficiaries. Essential to that role is to ensure that resources exist to finance the retirement system benefits, such as pensions, guaranteed in [MGL Chapter 32](#). In this capacity, the board relies on actuarial analysis of the assets and liabilities to determine its funding obligation.

By statute, an actuarial valuation is required once every three years. It provides the amount of the system's assets and accrued liabilities as of a specific date based on assumptions regarding past experience and anticipated factors (e.g., inflation, salary increase rate, and investment return) from which the funding schedule is derived. A funding schedule includes the normal cost (the amount needed to offset active members' accruing benefits for the current year) and the unfunded pension liability (the difference between the actuarial accrued liability and the pension fund's assets) of the retirement system.

Historically, retirement contributions to public pension systems were on a pay-as-you-go basis, paying only what was necessary to provide for the current year's retiree costs. However, this method of payment did not "fund" the system (accumulating assets to pay for each member's benefits during active service). Because the retirement systems were not providing for normal costs timely, they were generating unfunded pension liabilities that, if not addressed, potentially threatened the fiscal stability of the state, cities, and towns. Therefore, to address this issue, MGL Chapter 32 was amended (Chapter 697 of the Acts of 1987) requiring each public retirement system to provide for its normal cost and to eliminate the unfunded pension liability by 2028.

Based on the actuarial valuations, the unfunded pension liability and the funded ratio (the actuarial value of plan assets divided by the actuarial accrued liability) are determined. When a system's unfunded liability reaches \$0 and its funded ratio reaches 100 percent, a system is said to be "fully funded" and is only required to make appropriations to cover normal costs. Based on the funding schedule, annual contributions to the system are made through assessments levied upon the public sector governing bodies that participate in a system. Employees also contribute to the pension fund through payroll deductions, but the state, cities, and towns pay for the majority of the annual appropriation. To help offset the impact of these assessments on state and municipal budgets, each retirement board makes management decisions about the investment of the system's assets. A retirement board may invest its own funds, hire investment managers, and/or participate in the state-run Pension Reserves Investment Management ([PRIM](#)) fund.

Recent financial market history has proven that the environment in which Massachusetts public pension systems operate is constantly changing. The markets performed above average in the mid to late 1990s, experienced a downturn between 2000-2002, and rebounded between 2003-2004. As each new actuarial

valuation is completed, the value of the system's assets is determined. When the markets flourished, systems' assets grow, but when the markets experience a decline, those assets could decrease in value. If a retirement fund's return on investment is greater than the actuarial assumption, the unfunded pension liability will decrease. This assumes that the system does not incur actuarial losses on plan liabilities (e.g., wage increases greater than expected) or additional costs (e.g., adoption of an early retirement program). If there are gains, a retirement system may maintain its funding schedule and adjust its "fully-funded" date to be sooner than originally projected. Because there has been widespread difficulty balancing budgets throughout the Commonwealth over the last few years, a retirement board may, with the approval of PERAC, revise its pension funding schedule and adjust the members' assessments within the maximum number of years left prior to the statutory deadline of 2028. When the market results are less than actuarially projected or, worse, a retirement system's assets lose value, the retirement board must take corrective action to recover the loss. If the retirement system is scheduled to be "fully-funded" before 2028, a retirement board may, again with the approval of PERAC, revise its funding schedule, by lengthening it and/or increasing the amortization payment rate. If, however, the original funding schedule anticipated using the full 40 years to accomplish a "fully-funded" pension system by 2028, then the retirement system has no choice but to increase the assessments levied upon the participating cities and town.

As the retirement systems close in on the halfway mark to the statutory deadline to be "fully funded" by 2028, most funds still have an unfunded pension liability. Furthermore, many cities and towns are facing steadily growing assessments with limited resources available to fund these fixed costs. Therefore, it is recommended that cities and towns consider the following when planning and managing retirement obligations.

- **Analyze the Impacts of Benefit Decisions** – Local decisions such as salary increases, other employee benefits granted, and early retirement packages have a direct impact on the community's current operating budget as well as future pension and other post-employment benefit costs ([OPEB](#)). Consequently, decision-makers should be informed of all current and future costs before taking action.
- **Conduct Frequent Actuarial Valuations** – PERAC believes that an actuarial valuation of a retirement system should be done at least every two years, which enables the system to maintain more up-to-date data and ensures that funding schedules are in fact accurately addressing system liabilities. Having timely information enables decision makers to take corrective action when necessary.
- **Adopt Responsible Financing Plans** – Those systems that adopted aggressive funding schedules from the beginning generally are in a better position than those that deferred payments until the latter years. PERAC has found that the more successful systems have not reduced funding schedule levels, but rather have adopted more conservative measures when actuarial gains would allow a decrease in the annual appropriation. This action is prudent and provides flexibility in case of an economic downturn.
- **Establish a Pension Reserve Fund ([MGL Ch 40 §5D](#))**– Despite revisions to a system's funding schedule, some communities have maintained the higher funding requirement, placing the revenues not

required by the retirement system into an investment account. Establishing a Pension Reserve Fund enables the community to set aside funds designed to absorb dramatic assessment increases, but current statutes limit the investment options of these funds by local treasurers.

- **Provide Accelerated Payment Options** – Some pension systems are beginning to have actuarial studies done by unit (e.g., city, town, authority, or district), so that a fairer allocation of the system's liabilities is determined. A secondary benefit to this approach is the ability of participating public entities to make accelerated payments that would be credited to the unit's separate account, which at least two systems are currently considering. These additional contributions would be invested in higher yielding instruments available only to retirement systems, and be applied to the community's individual unfunded pension liability.
- **Review Investment Performance** – It is the responsibility of the retirement board to be diligent in the oversight of the system's activities and results. In doing so, the board should compare its long-term investment performance with other systems' and that of the PRIM fund. If the system's performance is below the other systems, the board should review its investment strategies and/or consider participating/investing more in PRIM.
- For more detailed information and definitions, please refer to [PERAC's educational materials](#) such as [Actuarial Valuation Basics](#) and [annual report archive](#).

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